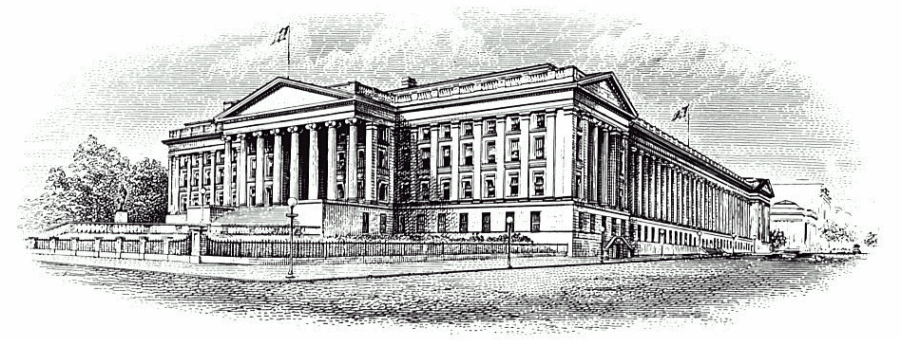

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

For Immediate Release
May 1, 2003

Contact: Tara Bradshaw
(202) 622-2014

STATEMENT OF PAMELA F. OLSON
ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY

BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS

Mr. Chairman, Ranking Member Velazquez, and Members of the Committee:

I am pleased to be here today to discuss the efforts of the IRS to reduce the burdens of tax compliance on small businesses and the Regulatory Flexibility Act (RFA).

ADMINISTRATION PRIORTY ON REDUCING SMALL BUSINESS BURDENS

The entire Administration, including the IRS and the Department of the Treasury, is committed to working closely with the small business community and its representatives to help small businesses and the self-employed understand their tax obligations and reduce their compliance burdens. We believe our record bears out this commitment.

The newly restructured IRS is built around four organizational units with end-to-end responsibility for serving specific groups of taxpayers. One of these units is the Small Business and Self-Employed (SB/SE) Operating Division, which serves the approximately 7 million taxpayers that are small businesses. SB/SE exists because the IRS recognizes that small businesses have unique issues that could be given short shrift unless a specific operating unit was devoted to them. In addition, because the IRS recognizes that these taxpayers may lack the financial resources to understand and address these unique issues, one of the primary focuses of the SB/SE Division is to work with small businesses to teach them about their federal tax responsibilities and to develop less burdensome and more practical means of compliance. The SB/SE Division has also assumed an important role in reviewing IRS regulations to ensure that they minimize burdens placed on small businesses consistent with the requirements of the tax law and principles of sound tax administration.

We are extremely pleased that last December the Small Business Administration presented the IRS with its 2002 Agency of the Year Award. SBA recognized SB/SE's Taxpayer Education and Communication organization for its outstanding progress in creating an effective education and compliance assistance program for small businesses and the self-employed. We are committed to continuing this record of achievement in serving the small business community.

The IRS continues to expand the ways it communicates with small businesses. For example, in 1999 the IRS initiated "The Small Business Corner" on the IRS Internet site. It provides small business taxpayers with easy-to-access and easy-to-understand information necessary to comply with their federal tax responsibilities. The goal of this type of convenient "one-stop shopping" is to provide virtually all of the products and services that a small business needs to meet its tax compliance responsibilities.

The IRS has also initiated a comprehensive taxpayer burden reduction initiative. The Service-wide Taxpayer Burden Reduction Council develops, coordinates, and champions cross-functional or service-wide burden reduction projects. Small business taxpayers participate in the IRS Industry Issue Resolution Program, which includes taxpayer burden reduction as a program criterion. Recently implemented burden reduction projects benefiting small businesses include:

- Exempting 2.6 million small corporations from filing Schedules L, M-1 & M-2, reducing burden by 61 million hours annually. (April 2002)

- Reducing the number of lines on Schedules D, Forms 1040 and 1041, resulting in estimated burden reduction of 9.5 million hours for 22.4 million taxpayers. (January 2002)

- Eliminating the requirement for filing Part III of Schedule D (capital gains), Form 1120S for 221,000 S-Corporation taxpayers, reducing burden by almost 600,000 hours. (November 2002)

The IRS has also streamlined many of its procedures to make compliance less burdensome for small business taxpayers. A few examples include:

- The establishment of a permanent special group to work with payroll services to resolve problems before notices are issued and penalties are assessed against the individual small businesses serviced by these bulk and batch filers. (October 2002)

- Business filers can now e-file employment tax and fiduciary tax returns, and at the same time, pay the balance due electronically by authorizing an electronic funds withdrawal.

- Business preparers can now e-file their clients' employment tax returns.

- The IRS has continued to improve its Web site to offer its customers the ability to both order, and in many cases, utilize its Small Business Products online.

The IRS Website now includes the Electronic Marketing Card, which introduces small businesses and the self-employed to the SB/SE Division, and its mission, services, products, and contacts. Small business taxpayers can also automatically download tax events from the 2003 Small Business Tax Calendar into their Outlook calendars.

In addition, the Small Business Resource Guide, and the Virtual Small Business Workshop, are all now available to view online. The Virtual Small Business Workshop is powered by video streaming technology and is available through the Online Classroom. IRS customers can visit the Online Classroom when it is convenient for them. If a small business owner or self-employed individual needs to speak with someone from the IRS directly, he or she is just a click away from the "New Toll-Free Numbers to Reach the IRS" located on the Small Business Community homepage.

It is the long-term and continuing goal of the IRS and the Treasury to ease the burden of small businesses to the greatest extent practical, consistent with the law as enacted by Congress. We look forward to working with this committee as we continue those efforts.

THE BENEFITS OF TIMELY IRS GUIDANCE TO SMALL BUSINESS

Minimizing taxpayer burdens, whether for small businesses or other taxpayers, is a paramount objective of the regulations and other guidance issued by the IRS. Unfortunately, our tax laws have become devastatingly complex in recent years. That complexity threatens to undermine taxpayer confidence in the system, as people come to view the system as one that encourages aggressive tax planning by those with the resources to hire sophisticated planners. We view a system that puts people to the choice of being a cheat or a chump as inherently unstable. It is essential that we simplify the tax laws wherever and whenever we can. Just as importantly, we must refrain from making the system any worse than it already is.

It is important to emphasize that tax regulations and other guidance are, themselves, means by which taxpayer burdens are reduced. Regulations, rulings, and notices serve to make clear how the tax laws enacted by Congress will apply in the real life situations faced by businesses, including small businesses as they plan their affairs and file their tax returns. The business community desires and needs such guidance. Without it, the law would remain unclear and businesses would be forced to take their best guess, with the consequence being an IRS audit if the guess is wrong. With regulations in place, the guesswork (and the potential for an audit) is significantly reduced. Certainty – knowing how the IRS will interpret and apply a law written by Congress – is the most efficient and effective way to reduce the burden of small businesses complying with the tax law.

In developing tax guidance, Treasury and the IRS actively seek input from interested parties, including small business, and endeavor to offer as many opportunities as possible for interested parties to participate in the process. In almost all situations, the IRS issues proposed rules and in some cases advance notices of proposed rulemaking for public comment. The same is often done for draft revenue procedures. When public comments raise new issues, we often issue a second notice of proposed rulemaking. Treasury and IRS carefully consider all comments received from the public and we revise proposed rules to minimize burdens and

simplify compliance whenever possible, consistent with principles of sound policy and tax administration.

In this context, it is important to remember that IRS regulations do not make the laws that apply to small businesses or any other taxpayer. Congress does that by amendments to the Internal Revenue Code. The role of IRS and Treasury is to interpret and apply those laws. In that way, tax regulations differ greatly from regulations issued by other regulatory agencies. We provide taxpayers with the guidance they need to comply with their obligations under the Internal Revenue Code as enacted by the Congress.

Providing timely, comprehensive, and understandable guidance to taxpayers reduces controversy, eliminates disputes, and provides taxpayers with certainty concerning their obligations under the tax code. Just as important, clear IRS regulations and guidance minimize the likelihood that there will be contact between IRS and taxpayers. Without this guidance, compliance obligations would have to be established through burdensome taxpayer audits and costly litigation. Audits and litigation are a costly and inefficient means of interpreting the law.

For example, several years ago the IRS was devoting significant audit resources to examining the use of the cash method of accounting. This was one of the most heavily litigated tax issues. In order to reduce administrative and compliance burdens on small business taxpayers and to minimize controversy between the IRS and these taxpayers, we issued in December 2001 a proposed revenue procedure on the use of the cash method of accounting by small businesses and requested comments from the public on the proposed guidance. After considering the issues raised in the comments, we made changes and clarifications to the guidance and issued a final revenue procedure in April 2002. The final revenue procedure expressly permits certain businesses with gross receipts of less than $10 million to use the cash method of accounting. We expect that the revenue procedure will eliminate most disputes concerning the use of the cash method by small business taxpayers.

This example illustrates what may be a unique feature of tax regulations in that they interpret statutory tax obligations, but do not impose tax obligations. That is, the statutory requirements take effect, taxpayers must comply with them, and the IRS must enforce them. In the absence of regulations, the IRS must still enforce the law, and it will do so without the benefit of the interpretative guidance that the regulations provide. The result is likely to be increased cost and burden for taxpayers if regulations are not issued or are not issued on a timely basis.

The IRS and Treasury are committed to easing the burden on small business wherever possible, consistent with the laws enacted by Congress and sound tax administration. Reducing taxpayer burden frees up IRS resources for more important tasks, including aggressive pursuit of tax evasion.

IRS GUIDANCE AND THE REGULATORY FLEXIBILITY ACT

The Department of the Treasury and the IRS fully support the objectives of the Regulatory Flexibility Act.

In 1996, Congress amended the RFA to make it applicable to interpretative tax regulations to the extent that those regulations impose a collection of information on small entities. This amendment, which Treasury worked with the Congress to develop, recognizes two important elements of tax regulations. The first is that provisions of the Internal Revenue Code, as enacted by Congress, must be applied equally to all businesses regardless of whether they are large multinational corporations or small businesses down the street. The second is that paperwork burdens imposed by regulations that affect small businesses must be carefully considered by the IRS and minimized when possible.

The 1996 amendment made the RFA applicable to an interpretative tax regulation when that regulation is subject to review and approval by OMB under the Paperwork Reduction Act of 1995. That means that the IRS must prepare a regulatory flexibility analysis for any rule that imposes a collection of information on small businesses unless the IRS certifies that the collection of information will not have a significant economic impact on a substantial number of small businesses.

Treasury and the IRS take their responsibilities under the RFA very seriously. Indeed, every IRS regulation is reviewed by three different offices for compliance with the RFA, as well as the other laws and Executive orders that govern the regulatory process. The first review occurs in the Office of the IRS Chief Counsel, the second by tax counsel at the Department, and the third in the office of Treasury's General Counsel.

In addition, every single IRS rule is required by section 7805 of the Internal Revenue Code to be sent to the Chief Counsel for Advocacy for comment on its impact on small businesses. If the Chief Counsel submits comments, the IRS is required by law to respond to those comments in the final rule. The law imposes no such requirement on any other agency.

With one very limited exception for regulations involving information collections conducted in connection with civil or criminal enforcement actions, the 1996 amendment applies to any interpretative tax regulation that requires small business taxpayers to (1) report information to the IRS, (2) disclose information to any other person, or (3) maintain specified records. Whenever a regulation involves one of these requirements, the IRS is required to prepare a regulatory flexibility analysis or certify that the regulation will not have a significant economic impact on a substantial number of small entities and explain the basis for its certification. The IRS complies with these requirements for every interpretative regulation it issues.

We have heard some speculation that the IRS considers the 1996 amendment to apply only when a regulation results in small business taxpayers having to complete a new form. This is categorically not correct. This misconception is understandable because most people associate IRS paperwork burdens with the preparation and filing of tax returns or information returns.

Even when an interpretative tax regulation is not subject to the RFA because it does not impose a requirement for collection of information, it is the policy of the Department of the Treasury to minimize, consistent with statutory requirements and sound regulatory policy, the compliance and paperwork burdens that their regulations impose on small businesses. This policy, as well as the Treasury Department's overall policy and procedures for complying with the RFA, are reflected in the formal guidance developed by the Department and recently posted on our Website pursuant to Executive Order 13272.

Since the 1996 amendments to the RFA, we have identified 24 proposed or final rules for which the IRS has prepared an initial or final regulatory flexibility analysis. For many of these, the IRS prepared the analysis not because it believed that the paperwork components in the regulations imposed a significant economic impact on a substantial number of small businesses, but rather because to do so comported with the spirit of the RFA. For the balance of the regulations issued during that period, the IRS certified that the information collections contained in the regulations would not have a significant economic impact on a substantial number of small entities.

IRS GUIDANCE RELATING TO MOBILE MACHINERY AND INTEREST REPORTING BY BANKS

Finally, the letter inviting us to testify today raised concerns over IRS compliance with the RFA in connection with two specific regulations.

The first is a proposed rule that concerns excise taxes on certain motor vehicles issued in June, 2002. Under current law, various excise taxes are imposed to provide revenues to fund the Highway Trust Fund. Those statutory provisions are broadly written, applying to virtually all vehicles (and fuels for those vehicles) that are capable of traveling on highways.

IRS defines a highway vehicle as any self-propelled vehicle, trailer, or semitrailer designed to perform a function of transporting a load over public highways, whether or not it is also designed to perform other functions. The regulations (and not the statute itself) broadly exempt from those excise taxes vehicles that were, in essence, mobile machinery mounts. This exemption was consistent with the notion that, because the taxes were enacted to support the construction and maintenance of public highways, the applicable statutory provisions should only be applied with respect to vehicles generally capable of traveling on highways. The exception was apparently based on the assumption that vehicles that transport mobile machinery would make minimal use of public highways and thus would receive only minimal benefit from highway construction and maintenance.

This broadly-written exception, however, was the source of much dispute between taxpayers and the IRS. Much of the disputes centered on what was and what was not mobile machinery, and reflected increasing technological advances that permitted heavier equipment to be mounted on vehicles perfectly capable of significant use of our highways. Many of those disputes involved very large rather than small businesses.

These factual and definitional disputes were and remain a continuous drain on taxpayer and IRS resources. We concluded that taxpayers needed more specific guidance in order to reduce the number of disputes and to provide certainty to taxpayers. The proposed regulations were developed with that goal in mind. We are aware that the proposed regulations were controversial, and have advised that they will not be finalized until the Congress completes its work on the Highway Trust Fund reauthorization.

An initial regulatory flexibility analysis was not prepared for this proposed rule because it does not meet any of the requirements for such an analysis under the 1996 amendment. The regulation does not contain any requirement that any taxpayer report information to the IRS, report information to another person, or maintain specified records. While it is true that some small business taxpayers may become subject to these excise taxes if this rule is finalized, this is a function of the Internal Revenue Code and not the result of a collection of information contained in the regulation. Thus, the proposed regulation complied fully with the requirements of the 1996 amendment.

The second is a proposed regulation regarding reporting by banks in the United States on interest paid to certain nonresident alien depositors. This information reporting is intended to improve compliance with U.S. tax obligations, and will not unduly burden U.S. banks. Tax evasion through the use of offshore accounts is a significant and growing problem in the United States. Enhancing appropriate information exchange pursuant to our bilateral tax treaties in appropriate circumstances, subject to the strict protections of the confidentiality of taxpayer information, is an important means of reducing the opportunities for tax avoidance in the offshore sector. We must address the potential for tax evasion through use of offshore accounts or entities in order to maintain confidence of all Americans in the fairness of our tax system. This proposed regulation is just one element of our multi-faceted effort to protect the interests of honest taxpayers who are prepared to pay their fair share of U.S. taxes and who should not have to bear a greater burden because of the few who are less than honest. In today's world, it is more important than ever that no safe haven exist anywhere in the world for the funds associated with illicit activities.

The currently-pending regulation is the second proposed regulation on this matter. The original proposed regulation, which was issued in January of 2001, was withdrawn and re-proposed in July of 2002 following thorough consideration by the Treasury Department and the IRS of all the comments received on the January 2001 proposed regulation. The regulation as re-proposed was narrowed significantly in scope – requiring information reporting with respect to interest paid only to residents of sixteen countries that are major trading partners of the United States – in order to address the banking industry's concerns about the January 2001 regulation, which would have required information reporting with respect to interest paid to all foreign depositors wherever they reside. Moreover, the regulation was again issued in proposed form in order to provide another opportunity for those potentially affected to comment on its impact.

Treasury and the IRS have carefully considered the requirements of the RFA with respect to this proposed regulation. We do not believe that the information reporting that would be required under this regulation would have a significant economic impact on a substantial number of small entities. The depository accounts, the interest on which would be subject to reporting

under the regulation, tend to be with larger financial institutions operating in the United States because such institutions tend to maintain correspondent account relationships with financial institutions in the countries specified in the regulations. Thus, the number of small entities that would be required to undertake this reporting is expected to be small. To the extent small financial institutions have accounts for which reporting would be required under this regulation, the number of such accounts is expected to be very limited. Moreover, the amount of time required to complete the forms and statements that would be required is not substantial. The information reporting that would be required is consistent with the reporting that U.S. banks do currently for interest paid to U.S. persons and to Canadian residents and would build on systems already in place.

That concludes my prepared statement. I would be pleased to answer any questions the Committee may have.

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